No. 91-731

In the Supreme Court of the United States

OCTOBER TERM, 1991

HENRY F.K. KERSTING, PETITIONER

v.

UNITED STATES OF AMERICA and
COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the Anti-Injunction Act, 26 U.S.C. 7421, bars petitioner's suit to enjoin the collection of penalties imposed under the Internal Revenue Code.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 5a-9a) and the order of the district court (Pet. App. 2a-4a) are not reported.

JURISDICTION

The judgment of the court of appeals was entered on August 2, 1991. The petition for a writ of certiorari was filed on October 31, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner has a documented history of promoting tax shelters of dubious validity.[1] From 1982 through 1988, petitioner and corporations controlled by him had gross income in excess of $10,000,000 from the promotion and sale of participations in tax shelters (Pet. 6). Section 6700 of the Internal Revenue Code imposes a penalty against the promoter of an abusive tax shelter equal to the greater of $1,000 or 20% (10% for years prior to 1984) of the gross income derived by the promoter from the shelter. 26 U.S.C. 6700. Section 6701 imposes a penalty against any person who, by aiding in the preparation of any tax return, causes a tax liability to be understated; a separate penalty of $1,000 may be assessed for *each* taxable year with respect to *each* person whose return is understated through the actions of the aider and abettor. 26 U.S.C. 6701(b)(3). On October 16, 1989, petitioner was assessed an aggregate penalty of $1,545,201 under Section 6700 (Pet. App. 6a). On October 23, 1989, petitioner was assessed an aggregate penalty of $2,330,000 under Section 6701 (*ibid.*).[2]

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[1] See *United States* v. *Kersting*, 891 F.2d 1407 (9th Cir. 1989), cert. denied, 111 S. Ct. 49 (1990). Those shelters purported to generate substantial interest deductions for the participants when, in fact, the transactions that supposedly created the interest payments were circular loans between related entities that gave only the appearance, but not the substance, of a transfer of funds. In *Pike* v. *Commissioner*, 78 T.C. 822 (1982), the court concluded that similar deductions claimed by petitioner's investors were not allowable because petitioner's program did not create any true indebtedness and no interest was in fact paid.

[2] The Section 6700 penalty was based on the appropriate percentage of gross income for each taxable period from 1982 through 1988. The Section 6701 penalties were based on the

The procedures under the Code that allow a person to contest a deficiency in income, estate or gift tax in the Tax Court prior to paying the tax (26 U.S.C. 6612, 6213) do not apply with respect to penalties assessed under Section 6700 and Section 6701. See 26 U.S.C. 6703(b). When a Section 6700 penalty assessment is made, Section 6703(c) instead provides that the person assessed may pay 15% of the amount of the penalty within 30 days of notice and demand, file a claim for refund, and upon disallowance of the claim, file suit for refund in district court. After the expiration of the 30-day period, the full penalty must be paid before administrative and judicial review may be obtained. Similarly, a person assessed Section 6701 penalties may, by paying 15% of one such penalty ($150), file a claim for refund and, upon administrative disallowance of the claim, file a refund suit. Alternatively, a person may challenge the validity of a penalty by defending an enforcement suit or by suing for a refund following collection of the tax.

2. Petitioner did not avail himself of those procedures. Instead, he commenced this suit on November 3, 1989, seeking a declaration that the procedural requirements of Section 6703 are unconstitutional as applied to him and an injunction to restrain the government from collecting the assessments (Pet. App. 6a-7a).

The district court denied petitioner's motion for a preliminary injunctive and dismissed the case for lack of subject matter jurisdiction (Pet. App. 2a). The court held that the Anti-Injunction Act, 26 U.S.C. 7421, prohibits the maintenance of petitioner's action

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number of investors to whom taxpayer had sold the shelter program in each separate year (Pet. 6).

to restrain the assessment or collection of any tax, including tax penalties under Sections 6700 and 6701 of the Code. The court further held that taxpayer had failed to demonstrate that he fell within the narrow judicial exception to the anti-Injunction Act because he had not established that it was certain that the government could not prevail on the merits of the penalties and had also not established that he would suffer irreparable injury absent an injunction (Pet. App. 3a). The court therefore dismissed the complaint for lack of subject matter jurisdiction (Pet. App. 1a).

The court of appeals affirmed, holding that petitioner's failure to demonstrate irreparable injury was fatal to his claim (Pet. App. 8a). While petitioner had broadly alleged that he would suffer financial ruin in the absence of injunctive relief, the court concluded that petitioner had failed to provide evidence adequate to support that claim (Pet. App. 8a-9a).

ARGUMENT

The court of appeals correctly concluded that petitioner's action to enjoin the collection of tax penalties assessed under Sections 6700 and 6701 of the Internal Revenue Code is barred by the Anti-Injunction Act. The decision of the court of appeals does not conflict with any decision of this Court or of any other court of appeals. The decision rests upon the finding made by the two lower courts that petitioner had failed to meet his burden of proving that he would suffer irreparable injury in the absence of injunctive relief. Further review of this factual determination is not warranted.

1. The Anti-Injunction Act, 26 U.S.C. 7421, provides in relevant part as follows:

PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION

> (a) Tax.—Except as provided in sections 6212(a) and (c), 6213(a), 6672(b), 6694(c), 7426(a) and (b)(1) and 7429(b), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.[3]

This provision allows the United States to assess and collect taxes claimed to be due without judicial intervention and limits determinations of the appropriateness of such assessments to suits for refund. *Enochs* v. *Williams Packing & Navigation Co.*, 370 U.S. 1, 7 (1962); *Bob Jones University* v. *Simon*, 416 U.S. 725, 736 (1974). The Act recognizes "the Government's need to assess and collect taxes * * * with a minimum of pre-enforcement judicial interference." *Bob Jones University* v. *Simon*, 416 U.S. at 736; *Alexander* v. *"Americans United" Inc.*, 416 U.S. 752 (1974).

The bar against a suit seeking to restrain the assessment or collection of taxes applies to the penalties provided by Subchapter B of Chapter 62 of the Code, which includes the penalties involved in this case. Section 6671(a) provides that the penalties provided

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[3] Sections 6212(a) and 6213(a) of the Code relate to assessments entered in violation of the deficiency procedures of the Code. Sections 6672(b) and 6694(c) allow taxpayers to obtain stays of certain penalty collection proceedings if certain requisites are met. Section 7426(a) and (b)(1) allows district courts to issue an injunction in wrongful levy cases under certain circumstances. Section 7429(b) relates to district court review of jeopardy assessments. None of these specific statutory exceptions is relevant to this case.

in Subchapter B "shall be assessed and collected in the same manner as taxes" and that "any reference in this title [the Internal Revenue Code] to 'tax' imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter." [4] 26 U.S.C. 6671(a). The prohibition of the Anti-Injunction Act against suits to restrain the "assessment or collection of any tax" (26 U.S.C. 7421(a)) thus applies directly to the penalties at issue in this case.

Because the relief sought by petitioner falls squarely within the prohibition of the Anti-Injunction Act, the district court lacked jurisdiction to grant injunctive relief unless petitioner's claims fall within the narrow, judicial exception to the Act recognized in *Enochs* v. *Williams Packing & Navigation Co.*, 370 U.S. at 7. That exception applies only when a taxpayer establishes: (i) that it is clear, based on the most liberal view of the law and the facts known to the government at the time of the suit, that "under no circumstances could the Government ultimately

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[4] Petitioner, citing *Lipke* v. *Lederer*, 259 U.S. 557 (1922), asserts that the penalties assessed against him are in the nature of a punishment and thus do not come within the bar of the Anti-Injunction Act (Pet. 19-21). *Lipke* applies only to "penalties" or "fines" designed as punishment for criminal violations of statutes (259 U.S. at 561-562) and not to civil penalties designed to deter abuses of the tax system and to compensate the government for the revenues lost through the abusive practices of those subject to the penalties. Such penalties are not punishment for criminal acts. See *United States* v. *Halper*, 490 U.S. 435, 442-443 (1989); *Helvering* v. *Mitchell*, 303 U.S. 391, 404-405 (1938). Moreover, as is discussed in the text, the Internal Revenue Code expressly defines the penalties at issue in this case to be "taxes" for all purposes under Title 26, which, of course, includes the Anti-Injunction Act.

prevail" on the issue of the taxpayer's liability for the taxes and (ii) that without an injunction taxpayer will suffer an irreparable injury for which there is no adequate remedy at law. *Ibid.* See *Bob Jones University* v. *Simon*, 416 U.S. at 736-737.

Petitioner failed to satisfy either part of this test, and his suit was therefore properly dismissed. Petitioner made no attempt to produce facts to establish that the government could not ultimately prevail on its assessments. Petitioner's recitation of his contentions (Pet. 25-29) demonstrates only that he may have defenses to certain of the numerous assessments; it does not provide clear proof that the penalties may not ultimately be sustained.[5] Petitioner's arguments thus fall far short of the showing required by *Williams Packing* and *Bob Jones University*.

Petitioner's claim that he has met the second part of the *Williams Packing* test rests on his assertion that he will be financially ruined if he is required to pay the assessments before obtaining a judicial determination of their validity (Pet. 21-25). Both of the lower courts held, however, that petitioner failed to establish any such claim, noting that "he has submitted no supporting documentation to prove his financial status" (Pet. App. 3a) and that "[o]ur independent review of the record has revealed no evidence of harm

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[5] The assertion (Pet. 28-29) that the assessments are barred by the applicable statute of limitations is a claim that petitioner may raise in a suit for refund under Section 6401(a), which provides that "the term 'overpayment' includes * * * any internal revenue tax which is assessed or collected after the expiration of the period of limitation properly applicable thereto." 26 U.S.C. 6401(a). The mere assertion of such a claim, moreover, does not, as petitioner suggests (Pet. 29), render the assessments void or establish that the government will not ultimately prevail on the assessments.

beyond 'mere financial hardship'" (*id.* at 9a). That fact-bound determination does not warrant further review. See, *e.g.*, *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985). Moreover, it is well established that evidence of financial hardship is not by itself sufficient to lift the bar of the Anti-Injunction Act. See *Enochs* v. *Williams Packing & Navigation Co.*, 370 U.S. at 6; *Bob Jones University* v. *Simon*, 416 U.S. at 745.

2. Petitioner also claims (Pet. 10-19) that Sections 6700-6703 of the Internal Revenue Code violate due process (Pet. 10-19). This Court, however, has long held that due process is not violated by a statutory scheme that provides for judicial review of tax assessments in refund suits following payment or collection of the tax. See *Bob Jones University* v. *Simon*, 416 U.S. at 746 & n.20, quoting *Dodge* v. *Osborn*, 240 U.S. 118, 122 (1916) ("There is a contention that the provisions requiring an appeal to the Commissioner of Internal Revenue after payment of the taxes and giving [the] right to sue in case of his refusal to refund are wanting in due process and therefore there is jurisdiction [to issue injunctive relief prior to the assessment or collection of any tax]. But we think it suffices to state that contention to demonstrate its entire want of merit." (brackets in original)).

In *Phillips* v. *Commissioner*, 283 U.S. 589, 595-597 (1931), this Court rejected a challenge to the constitutionality of the system under which taxes may be assessed and collected summarily without the opportunity for prepayment administrative or judicial review. The Court concluded that due process is satisfied in these circumstances by the adequate opportunity for a post-payment judicial determination of

the validity of the tax.[6] See also *Commissioner* v. *Shapiro*, 424 U.S. 614, 630-633 (1976); *Alexander* v. *"Americans United" Inc.*, 416 U.S. 752, 758-760 (1974); *G.M. Leasing Corp.* v. *United States*, 429 U.S. 338, 352 n.18 (1977); *Fuentes* v. *Shevin*, 407 U.S. 67, 91-92 (1972); *Boynton* v. *United States*, 566 F.2d 50, 53 n.2 (9th Cir. 1977) ("Assessments made without prior notice of deficiency are constitutionally valid, notwithstanding the fact that Tax Court jurisdiction is foreclosed and full payment of at least a divisible part of the assessment must necessarily precede a refund suit in District Court").[7]

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[6] Petitioner errs in relying (Pet. 11-14) on *Jolly* v. *United States*, 764 F.2d 642 (9th Cir. 1985). *Jolly* involved a suit for the refund of penalties imposed under Section 6702. The Ninth Circuit rejected the argument that Section 6703(c) violates due process by requiring a penalty to be paid before the penalty assessment may be reviewed on the merits. 764 F.2d at 645-647. In the penultimate paragraph of the *Jolly* opinion, the court noted that Section 6703(b) "accords [taxpayers] greater procedural protection than they receive when other taxes or penalties are assessed" by allowing them to obtain both administrative and judicial review of the assessment after paying only 15% (instead of 100%) of the assessment, and by placing the burden of proof on the Commissioner rather than the taxpayer as is the case with actions for the refund of other taxes. 764 F.2d at 646-647.

[7] Petitioner's claims for the return of subpoenaed records and for attorney's fees (Pet. 29-30) are not properly before the Court. The court of appeals correctly held that the return of the subpoenaed records mooted that issue (Pet. App. 7a n.2). Since petitioner lost on the merits in both courts below, he quite plainly was not entitled to attorney's fees under the statutes that allow an award of fees to the "prevailing party." 28 U.S.C. 2412; 26 U.S.C. 7430.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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